16 April 1999

The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA NSW 2600

Dear Sir

Business Tax Reform
Deferred Company Tax/Dividend Streaming
Submission in Response to Consultative Document - "A Platform for Consultation"

There is increasing speculation that the Committee for Review of Business Taxation (RBT) is considering the possible recommendation of a Deferred Company Tax (DCT) in conjunction with a relaxation of the rules preventing companies from streaming dividends from domestic or foreign sources to either domestic or foreign shareholders.

We suspect that the RBT is considering such a position on the basis that the impact of a full blown DCT should be significantly mitigated by the gradual removal of tax concessions (e.g. accelerated depreciation) as well as by enabling companies to dividend stream. In particular, by enabling them to channel foreign source profits to foreign shareholders without any DCT or other tax cost.

The purpose of this note is to echo our serious concern in respect of such a proposal.

A DCT - even with dividend streaming - continues to have the propensity to adversely impact on reported corporate profits and on corporate dividend policy. Moreover, it exacerbates the already existing bias in our taxation system against Australian resident shareholders/institutions investing in Australian companies that are growing offshore.

We attach a relatively simple example demonstrating the potential serious impact of a DCT (with streaming) on an actual client scenario.

In short, there will generally be a DCT charge for any corporate if its Australian tax profits are insufficient to satisfy the dividend payout to its Australian shareholders.

Accordingly, companies who are required to use some or all of their foreign source profits to satisfy some or all of their Australian resident shareholders will incur a DCT charge or will have to alter their dividend policy to minimise it.

The impact of this on corporate behaviour is not only unacceptable, but would be totally contrary to an attempt to move towards an internationally competitive tax regime for Australian companies - be they large or small.

Such a proposal would adversely impact not only on large multinationals who have a growing foreign source income position but also on smaller corporates who are wholly or predominantly Australian owned but are exploiting offshore markets (e.g. high technology, computer software, consulting services, etc.).

Moreover, as mentioned earlier there is currently an existing bias against Australian resident shareholders investing in Australian companies seeking to grow offshore because, amongst other things, of the lack of imputation benefits that such shareholders can enjoy from such companies. This bias is currently at the shareholder level.

A DCT/streaming proposal would introduce this bias also at the corporate level. In other words, there would be an incentive for Australian corporates with substantial or growing offshore earnings to in fact reduce the level of Australian shareholders they had so that they could ensure that ultimately their Australian profits were sufficient to service their Australian shareholder base and so avoid a DCT charge to profits.

Australian corporates who were capable of continually matching the proportion of Australian shareholders they had with their proportion of Australian sourced profits may, in theory, be relatively unscathed by such a proposal. However, corporates have little control over their shareholder mix. Moreover, given commercial uncertainty, they obviously cannot effectively manage their domestic/foreign source profit mix. As a result, many existing corporates will be seriously disadvantaged by such a proposal, either immediately or, if their shareholder and profit mix changes, in the future.

We refer you to our early submission of 1 April 1999 on the subject of Australian Multinationals and Business Tax Reform wherein at page 3, we noted that if the existing problems with our tax system were not adequately addressed now:

> "Australian based multinationals with ever increasing foreign earnings will continue to appear - at least tax wise - less and less attractive to Australian resident investors and would become more attractive to US/UK fund markets if they were in fact based in the US or the UK".

The introduction of a DCT/streaming proposal would - rather than tackle this issue - exacerbate the problem and further pronouce the desire of such companies to relocate their structural head office.

Finally, we note that the DCT/streaming proposal is not one which was evident in the "A Platform for Consultation" document. Nor has the trade-off between introducing a DCT along with dividend streaming been publicly linked in the way that, for example, a 30% rate and the removal of accelerated depreciation rates has. Accordingly, corporate Australia has not had an opportunity to properly address this proposal in the submissions that are required to be lodged by the end of this week.

We therefore again echo the comments we made in our 1 April submission that:

> "Changes to our tax regime which inhibit or encourage the success of Australian multinationals are too important to be raised and concluded over a short period of time, without the benefit of important theoretical and practical input and within the confines of a revenue neutrality and political expediency constraint".

Should you have any comments or questions, please do not hesitate to contact Alf Capito on (02) 9964-6000.

Yours sincerely

Copies to:
Mr John Ralph AO
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DCT with Streaming

Impact on Reported Profits and Dividend Policies

	(Approx.)	
Foreign Income	70	tax exempt (already subject to Foreign Taxes)
Aust Income	30	pre-tax
	100	
Aust. Tax (@ 33% say)	(10)	assuming a reduction to 33% from 36%
After-tax Profit	90	
	===	
Franking Credits	20	

	Foreign Shareholders	(Approx.) Domestic Shareholders	P&L Effect (DCT)	Total Outflows
Shareholder Mix:	30%	70%		
Div Policy - 80% distribution				
Pre-DCT Scenario				
Pre-DCT Dividends	22	50		72
Post-DCT Scenario				
(Assuming DCT and Dividend Streaming is available and Implemented with few impracticalities)				
Domestic Profits		20		20
Foreign Profits	22	30*		52
DCT (30 x 33/66)			15	15
Post-DCT Dividends and DCT	22	50	15	87
	==	==	==	==

Total Outflows are 87 compared to 72 under existing regime.

After-tax profits are adversely impacted by 15 DCT charge or by 17% (i.e. 15/90 = 17%) if existing dividend payment policy (on a pre-DCT basis**) is to be maintained.

Notes:

* Subject to DCT.

** The corporate could change its dividend payout due to the reduced profit from the impact of DCT. Moreover, it could choose to drastically reduce its dividend to minimise the DCT. In either case, the DCT has an unacceptable impact on corporate behaviour.